Memorandum

Subject [redacted]	Date June 20, 1996

To Frito-Lay File   From Nina Hale

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On June 19th, Jill Ptacek, Cindy Alexander, Neeli Ben-David and I traveled to [redacted]

distribution: RWF, DNK, HALE, PTACEK, ALEXANDER - EAG, SWEENEY, JONES, CASE, CHRON, ARCHIVE

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[redacted] In addition, he acknowledged that the "aisle is cleaner." He said that "people are out of the business or, if they're still in the business, they cannot play." By that, he meant that there are players in the market who are confined to secondary or tertiary markets because they are unable to pay the price of being on the

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[redacted] stated that the markets in which Frito has no competition are Dallas (Winn-Dixie, for example, only, carries Frito and its private label), Denver, San Francisco, and Los Angeles. He believes that Frito is subsidizing its marketing on the east coast with the high prices that it charges in those markets. He said that there is no other chip company of any substance west of St. Louis. He said that Frito has a 55 percent share of all snack foods and is capable of monopolizing the industry by taking share through exclusionary tactics. By the same token, [redacted] admitted that Frito is a great packaged goods company that, over the last 10-15 years, has dramatically improved its product quality and has been able to cut its costs.

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We asked [redacted] to talk about the grocery chains on the eastern seaboard where [redacted] products are sold. He identified several. One is Acme which is located in Philadelphia. Another chain in the eastern seaboard is Giant of Landover. Giant is a smart, prosperous chain that sets its shelf space based on the "space to sales ratio." Another chain is Super Fresh, which is owned by A&P. This is not a profitable chain and according to King, "it cannot think beyond the next quarterly meeting with its analyst." It is strapped for cash, and therefore is willing to give disproportionate space to a supplier who is willing to pay for that space or for exclusivity. Giant, on the other hand, does not sell space. It sells co-op advertising.

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In New York, Frito is number one. The number two firm is Wise's, which is distributed through a company called Brown Distributors. [redacted]

Herr's and Bachmans are also in the market and are distributed through both company-owned and independent distributors. [redacted]

As already stated, [redacted] refuses to pay fees to stay on the shelf in its core market. But, the fact of the matter is that stores in [redacted] core market don't ask for [redacted] "pay to stay" fees given the size of its market share. However, in new markets, [redacted] has paid the fee. These additional marketing costs eroded [redacted] base margins. [redacted] said that [redacted] base margins have gotten better than they were a few years ago, but these have increased due to cutting costs, rather than increasing price. (7)(D)

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[redacted] says that the problem with this so-called space/sales program is that it is used sporadically and the information is in the hands of the chains, who use it selectively to their benefit. (What a surprise?) In addition, a lot of the information came from Frito-Lay who says "we will manage the information for you." Some chains have said "thanks, but no thanks." But others have said, okay.

We asked [redacted] what this information was and why he was unable to pull the same information that Frito generates off the [redacted] hand-held computers to basically question the store's determination that a particular supplier has more shelf space than its sales justify. He was not aware that he could obtain Nielsen data on a chain-by-chain basis in a region. We told him that we thought otherwise and he said he would check it out. But, he said that the two sources of information are [redacted] sales for the chain and the Nielsens for the market as a whole. [redacted] said that [redacted] represented over 20 percent of supermarket sales in Philadelphia (Supermarket sales account for 65 percent of the business available to chip makers).

[redacted] went through a number of categories of exclusivity seeking behavior that Frito has engaged in. His view is that Frito's policy is to seek exclusivity wherever it can get it. The first kind that [redacted] has experienced, is that Frito locks up the best potato growers. He says that it is easy for Frito to do this because, in some case, it represents 55 percent of the market. With that buying power, Frito-Lay then offers growers the status of "Frito-Lay preferred grower." This status does not mean that a grower cannot sell to others, but it does mean that Frito is entitled to take the best of the grower's crop, test its developmental products with that grower's fields, and permits Frito-Lay to tell the grower to dig for the potatoes when there is a drought or force growers to take back potatoes that Frito has committed to buy if there is a glut. [redacted] b7D

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With regard to Frito's conduct, vis-a-vis, the packaging suppliers, again Frito is making use of its power as a buyer and is able to get the suppliers to dedicate production lines to the Frito bags in exchange for volume discounts and long-run quantities.

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We talked a little about the notion of relevant product market being all salty snacks or the individual products such as tortilla chips, potato chips, or pretzels. Having admitted that consumers are likely to be thinking in terms of different brands of chips, versus chips or pretzels, [redacted] nevertheless believes that the market would be all salty snacks because that is the reference for other manufacturers in terms of measuring market share, as well as the perspective of the retailers insofar as they organize the products on the shelf and define their relationship with suppliers. He said that most stores let the supplier choose the mix of products in the designated space that has been allocated on the basis of all salty snack sales of that supplier. He said that most stores use manufacturers sets rather than category sets. [redacted] The use of manufacturer sets permits the supplier to set the strategy for display of its products within that space. [redacted] He did say that there was some trend toward organizing all the manufacturer's potato chips together and all the manufacturer's pretzels together, but this is not taking over the industry.

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[redacted] then went on to discuss some of the demand side exclusivity tactics that Frito engages in. He reiterated that these practices are not a big problem [redacted]

[redacted] He will provide us the details of those incidents in writing in the near future.

He then discussed the other kinds of exclusivity besides total exclusivity. He alluded to the supplemental display space exclusivity, which Frito either buys or ties to a rebate deal. There are also the category exclusives, whereby Frito obtains a commitment from the store that the store will only carry Frito's 50-cent bags or that Frito will buy out a certain number of the SKUs to limit the number of suppliers that the store can have on the shelf. And finally, there are the promotional exclusives, wherein Frito obtains an exclusive for peak promotional periods. He said that Frito takes a fall back approach with these various types of exclusivity. By that, he means that if Frito can't get all the space in the store, then they will seek to get exclusivity on the supplemental display space. If they can't get all the space in the store or exclusivity on the supplemental display space, then they go for a category exclusive, etc., etc. In this game, Frito wins because it has the money and it ties its programs together into a comprehensive marketing scheme that is very attractive to the retailer.

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[redacted] didn't seem too concerned about the practice of "dummying up" shelf space. They said they would do it if the situation arises -- (1) to avoid having to pay again for the space if they tell the retailer they need it; (2) because they will make money off the business from those shelves giving it room to grow; and (3) to avoid it getting into a competitor's hands.

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We talked a little bit about private label. The issue here was one that Cindy raised and that was, if a firm is doing private label, doesn't that mean that the firm could reenter under its own name in the event that Frito, for example, was engaging in monopoly pricing. [redacted] said this was not necessarily the case. First of all, the firms that are doing only private label are, in his view, losers. You don't start out as a private label firm, you evolve into one. As a private label firm, you have no resources because the margins are very, very thin. In addition, most private label firms do not do direct-store delivery. Instead, they deliver to the warehouse of the store for whom they are doing the private label and the store employees are responsible for stocking the product. In addition, a private label firm does not do any marketing for the product. There are a few firms doing private label that have maintained their DSD network from their time as a branded supplier. For example, Nibble with Gibbles is such a firm. But, according to [redacted] we should think of private label firms as a production plant and nothing more. Finally, we tried to get a little bit of information about the types of arrangements [redacted]

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[redacted] They will be providing us with some information on the degree of foreclosure from the various accounts that they have experienced foreclosure, demonstrated to us the volume of revenues and affect on their distribution costs. In addition, they will provide us with information about market share.

So/So # 11546